

Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison
Company (U 338 E) for Order Approving
Settlement Agreement Between Southern
California Edison Company and SGF, Ltd.

Application 04-07-041
(Filed July 26, 2004)

OPINION APPROVING SETTLEMENT**1. Summary**

Southern California Edison Company (SCE) seeks expedited approval by the Commission of a settlement agreement resolving complex litigation arising out of SCE's power purchase agreement with SGF, Ltd. (SGF), the owner of a wind-power qualifying facility (QF) in the Palm Springs area. The settlement resolves two years of litigation and negotiations, including mediation before a neutral mediator and a court-supervised settlement conference. According to SCE, the settlement agreement resolves all of SGF's pending claims, provides substantial ratepayer benefits, and avoids the expense and risk of continued litigation. The application is unopposed. The application is granted.

2. Background

The claims in this matter arose from a power purchase agreement between SCE and SGF dated January 17, 1985. The agreement was an Interim Standard Offer Number 4 (ISO4) contract approved by the Commission for the sale of electric energy and capacity by QFs under the Public Utility Regulatory Policies Act (PURPA), Publ. L. No. 65-617, 92 Stat. 3177. Pursuant to the contract, SGF

agreed to sell electric energy and “firm capacity” to SCE for 25 years, beginning in 1985.

In entering into an ISO4 contract, a seller like SGF selects how it will be paid for “capacity,” that is, the payment it will receive for supplying SCE with power in a manner that reduces SCE’s need to build additional production capacity. A seller that selects an “as-available” capacity makes no commitment that it will deliver electricity in any particular quantities. A seller that selects a “firm capacity” option commits to provide a stated amount of power, except for forced outages and scheduled maintenance.

The capacity payments that SCE makes to a seller that selects the firm capacity option are based on a levelized price that is significantly higher during the initial years than the price SCE pays for as-available capacity. It is premised on a seller’s commitment to supply a certain level of capacity over the entire contract term. In turn, a firm capacity seller must satisfy contractual performance tests to show that it is delivering certain minimum quantities of electricity to SCE during specified hours of peak demand during the summer. This is known as the “Summer Peak Performance Requirement.”

Additionally, firm capacity sellers are subject to other capacity demonstration tests conducted by SCE. If a seller fails to satisfy its performance requirements, SCE may reduce, or “derate,” the contract capacity level and recover any unearned capacity payments that have been paid to the seller, plus interest.

SGF elected the firm capacity payment option. SGF generates electricity through wind power. Wind is an inherently variable source. SGF is alleged to have failed to supply committed capacity during a peak performance period. Its contract capacity was derated from 10,000 kilowatts (kW) to 8,500 kW. This

resulted in an earlier lawsuit between SGF and SCE in 1996 that was subsequently settled. (*See* SCE 1999 Annual Transition Cost Proceeding, Application (A.) 99-09-013; Exhibit SCE-2 at 121-131.)

SGF initiated the litigation involved in this application on September 18, 2001, in the Superior Court in Riverside County. The litigation contests SCE's conclusion that SGF again had failed to demonstrate the required contract capacity during the year 2000 demonstration test. Based on that test, SCE derated SGF's capacity effective June 2000 from 8,500 kW to 4,880 kW. SCE charged SGF \$809,534, representing what SCE claimed were overpayments to SGF. SCE offset the charged amount against energy and capacity payments otherwise owed to SGF. In addition, commencing with deliveries from the project on and after June 1, 2000, SCE made capacity payments based on the derated 4,880-kW level and has continued to make payments on that basis since that time.

3. The SGF Lawsuit

In its lawsuit, SGF alleged that SCE breached the terms of the QF contract by erroneously conducting the capacity demonstration test. SGF demanded a return of the claimed overpayments and interest. The complaint further accused SCE of unfair business practices aimed at obtaining electrical generating capacity from wind producers without paying adequate compensation, an allegation which, if proven, could require treble damages. In addition, SGF claimed that as a result of the pendency of the deration dispute, it lost the opportunity to enter into an agreement (the Fixed Rate Agreement) made available by SCE to other renewable QFs to settle claims resulting from SCE's suspension of payments to energy producers for electricity deliveries between December of 2000 and late March 2001. (*See* Decision (D.) 01-06-015 and D.01-07-031.)

SCE demurred and moved to strike SGF's unfair business practices claim and its request for treble damages, contending that California's Unfair Competition Law does not allow claims for breach of contract like this one to be converted into tort actions. On November 9, 2001 the parties stipulated to an order striking SGF's request for treble damages and withdrawing SCE's demurrer and motion to strike. SCE then answered the complaint, denying all of its material allegations.

During the course of 2002 and 2003, SCE and SGF engaged in extensive discovery, including seven depositions. SGF produced over 500 pages of documents in response to SCE's document requests, and SCE produced several thousand pages of documents for examination by SGF. On November 14, 2002, SCE moved for summary adjudication on SGF's claim for alleged damage because it was not included in the Fixed Rate Agreement.¹ SCE asserted that SGF's failure to execute a claim was not, as a matter of law, proximately caused by any alleged wrongful conduct by SCE with respect to the capacity demonstration test. SGF agreed with SCE's position, and the Fixed Rate Agreement claim was withdrawn by stipulation.

Trial was initially set for January 2003 but was postponed to permit completion of discovery. A new trial date was set for November 2003. Meanwhile, the parties participated in a Judicial Arbitration and Mediation Services (JAMS) mediation with a retired judge. On October 3, 2003, the parties participated in a court-ordered mandatory settlement conference. Negotiations continued after the settlement conference, and a settlement in principle was

¹ In March 2002, SCE paid SGF an amount that SGF agreed constituted full compensation for payment suspension period deliveries.

reached a few days before the scheduled trial date. The parties memorialized the settlement agreement, which was executed on June 10, 2004.

4. Proposed Settlement of Lawsuit

On July 26, 2004, SCE filed this application for approval of the settlement agreement with SGF. At the same time, SCE filed a motion for a protective order to preserve the confidentiality of certain portions of the application, stating that their disclosure could cause SCE competitive harm in negotiating settlements with other QFs. The motion was unopposed and was granted on August 30, 2004.

SCE filed public versions of its application, the power purchase agreement between it and SGF, and the prepared testimony of SCE's director of QF resources and an SCE financial analyst. SCE also filed non-public versions of its application, the testimony of its witnesses and the settlement agreement between SCE and SGF. The non-public versions of the application and the testimony include confidential information on the reasonableness of the negotiations and the benefits of the settlement agreement to ratepayers.

SCE states that the settlement agreement will result in the dismissal of pending litigation and will resolve all outstanding issues between SCE and SGF. SCE requests an expedited approval since the settlement will terminate on December 1, 2004 if Commission approval is not obtained, with a potential resumption of litigation.

In order to determine terms and provisions of the settlement, we reviewed the non-public versions of the application, the prepared testimony, and the settlement agreement, as well as the QF contract. We note that the protective order does not apply to Commission staff, which also was free to review the non-public portions of the record. Other entities, such as those that might have

wanted to protest the application, were able to review the confidential information upon executing a nondisclosure agreement. The following discussion of the issues is based on our review of the settlement agreement and all of the other pertinent documents.²

5. Discussion

The Commission's settlement rules are found in Rules 51 to 51.10 of the Rules of Practice and Procedure. They provide a standard for review of this settlement. Specifically, Rule 51.1(e) provides in pertinent part that the Commission will not approve a settlement unless it "is reasonable in light of the whole record, consistent with law, and in the public interest." In its Diablo Canyon decision (D.88-12-083), the Commission set forth applicable criteria, drawn from federal and state court decisions reviewing proposed class action settlements:

In order to determine whether the settlement is fair, adequate, and reasonable, the court will balance various factors which may include some or all of the following: the strength of the applicant's case; the risk, expense, complexity, and likely duration of further litigation; the amount offered in settlement; the extent to which discovery has been completed so that the opposing parties can gauge the strength and weakness of all parties; the state of the proceedings; the experience and views of counsel; the presence of a governmental participant; and the reaction of the class members to the proposed settlement. (D.88-12-083; 30 CPUC2d 189, 222.)

² We note that this was the approach followed by the Commission in earlier decisions reviewing settlements between utilities and QFs that included confidential information filed under seal. (See D.02-04-014 (SCE-NP Cogen Settlement); D.97-12-067 (SCE-Limited Partnerships Settlement).)

SCE has presented a lengthy discussion of the factors leading to the proposed settlement here. SCE states that many of the issues in the lawsuit are technical ones, turning on specialized contract language and practices in power purchase agreements. A jury could find, as SGF claims, that the capacity demonstration tests were not conducted in the manner agreed to by the parties, and that the contract language and amendments were unfair to wind-based QFs. In the past, lawsuits of this nature have contemplated a two-month jury trial. (*See* D.97-12-067.)

SCE states that its proposed settlement with SGF was reached on the eve of trial after protracted arm's-length negotiations, including a full-day mediation and a court-ordered settlement proceeding. Exhibits submitted with the application show that the proposed settlement represents a substantial savings to SCE's ratepayers over an adverse outcome in the lawsuit. The exhibits also show that the proposed settlement is only marginally different from the costs that SCE ratepayers would absorb even if SCE were to prevail on all elements of the lawsuit. The settlement places a limit on SCE's future energy costs under the parties' capacity agreement. Each of the parties was represented by counsel experienced in QF litigation, and discovery for the most part appears to have been completed.

Litigation risk is not as easily weighed as the results of a financial analysis. Litigation risk includes not only direct monetary impacts but also indirect impacts that might affect existing contracts and negotiations with other QFs. Thus, we have considered not only the potential impacts of continued litigation between SCE and SGF, but also the potential implications of future litigation between SCE and other QFs. Based on the issues resolved by the settlement, the litigation risks that SCE could be exposed to if these issues and the dispute were

litigated, and in potential future litigation with other QFs, we conclude that the proposed settlement is reasonable, consistent with the law, and in the public interest. Accordingly, the settlement agreement entered into between SCE and SGF is approved. Consistent with Rule 51.8, this settlement is not precedential and does not constitute approval of any principle or issue in future proceedings.

6. Categorization of Proceeding

In Resolution ALJ 176-3137 dated August 19, 2004, the Commission preliminarily categorized this decision as ratesetting, and preliminarily determined that no hearings would be necessary. Our examination of the record persuades us that a public hearing is not necessary, nor is it necessary to alter the preliminary determinations.

7. Section 311 Comments

This is an uncontested matter in which the decision grants the relief requested. We waive the 30-day comment period otherwise required by Pub. Util. Code § 311. (*See* Pub. Util. Code § 311(g)(2).)

8. Assignment or Proceeding

Geoffrey F. Brown is the Assigned Commissioner and Glen Walker is the Assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. SCE and SGF entered into an ISO4 power purchase agreement on January 17, 1985, with a term of 25 years.
2. SGF elected to provide SCE with firm capacity under the contract.
3. SCE in June 2000 derated SGF's capacity from 8,500 kW to 4,880 kW and charged SGF \$809,534 on grounds that SGF failed to demonstrate the required contract capacity.
4. SGF sued SCE in Riverside County Superior Court on September 18, 2001.

5. SGF in its lawsuit alleged breach of contract, unfair business practices and lost opportunity to enter into the Fixed Rate Agreement.

6. Following two years of discovery, mediation and settlement discussions, SCE and SGF entered into a settlement agreement shortly before the trial date in November 2003.

7. On July 26, 2004, SCE filed this application for approval of the settlement agreement with SGF.

Conclusions of Law

1. The application is unopposed.
2. Rules 51 to 51.10 should be used to review the proposed settlement agreement.
3. The terms of the proposed settlement agreement are reasonable, consistent with law, and in the public interest.
4. The settlement agreement entered into between SCE and SGF should be approved.
5. Consistent with Rule 51.8, this settlement is not precedential and does not constitute approval of any principle or issue in future proceedings.
6. This order should be effective today in order to allow the settlement agreement to be implemented immediately.

O R D E R

IT IS ORDERED that:

1. The application of Southern California Edison Company for approval of a settlement agreement with SGF, Ltd. is approved.

2. Application 04-07-041 is closed.

This order is effective today.

Dated _____, at San Francisco, California.